



News Release

TRA Proposes to set the Cost of Capital Applicable to the Regulated Telecommunications Activities of Batelco and Zain at 9%

Manama, Kingdom of Bahrain - Tuesday 21 July 2009

The Telecommunications Regulatory Authority (TRA) has issued for public consultation a draft determination on the cost of capital applicable to Batelco and Zain.

The draft determination is proposing to set the cost of capital for both companies at 9%. The current cost of capital applying to Batelco was set at 12.2% in 2005. The objective of the determination is to set the appropriate level of the nominal cost of capital and therefore the rate of return applicable for regulated telecommunications services in the Kingdom of Bahrain.

TRA's General Director Mr. Alan Horne said: "It has been almost four years since the cost of capital has been determined. There have been many changes in the industry and global environment since that time and the cost of capital needs to be adjusted so as to be fair and reasonable to all parties reflecting the current environment. To establish the revised figure, TRA has been assisted by specialist consultants who have undertaken a rigorous study and analysis to arrive at our recommended figure"

The cost of capital can be defined as the rate of return required by investors for investing in specific activities. Because risks vary by sectors, the cost of capital of a construction company is expected to be different from that of a telecommunications company: whereas the construction sector is cyclical and subject to ups and downs, the telecommunications sector is more stable and less prone to fluctuations. Telecommunications is more like a public utility: even in difficult economic times, people make phone calls and use electricity but they can postpone the construction of their dream house.

The regulated rate of return is a key regulatory parameter affecting the cost base of operators and has an impact on the price paid by consumers for telecommunications services. Setting the cost of capital at an inappropriate level may deter efficient investment (risk of under investment) or encourage inefficient investment (risk of over investment), both of which would be detrimental to consumers and the sector more generally. It could also lead to unjustifiably high prices. Thus it is essential to set the cost of capital at a fair and reasonable level in line with the underlying risk of the business.

To estimate the cost of capital, TRA has had regard to international best practice, latest available market information, regulatory precedents and the current economic environment. TRA considers that the proposed rate provides the right investment incentives while preventing excessive profits.

At present only certain of Batelco's services are regulated. After finalising the on-going consultation on mobile termination rates (the charge paid by an operator to terminate traffic on a mobile network) it is likely that Zain's mobile termination rate will be regulated.

A change to the cost of capital impacts the regulated cost of operators in different ways. For example lower network cost means that Batelco retail can pass on to consumers the cost savings. Similarly, other operators who rely on wholesale products to provide broadband or terminate traffic, can compete more aggressively and lower their retail prices. Through the competitive process lower cost at the network level can be expected to flow through retail prices. As lower prices generally stimulate demand, overall revenues may further increase.

Alan Horne concluded "TRA is very mindful of the potential adverse effect of setting the rate of return too low and this is why it has taken a conservative approach and factoring the on-going uncertainty of the current economic climate in its estimate. The estimate of TRA corresponds to a fair and reasonable rate of return enabling regulated companies to finance their operations and undertake investment."

The Draft Determination can be viewed on TRA's Website at www.tra.org.bh. Interested parties are invited to review and provide comments to TRA by 4:00 pm on 23 August 2009.

About TRA

The Telecommunications Regulatory Authority (TRA) was established by Legislative Decree No. 48 of 2002 promulgating the Telecommunications Law. TRA is an independent body and its duties and powers include, among other things, protecting the interests of subscribers and users and promoting effective and fair competition among existing and new licensed operators. More information regarding TRA can be viewed at www.tra.org.bh

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